58



IN THE

# Supreme Court of the United States

No. 535

C. W. TITUS, *Petitioner*

v.

THE UNITED STATES OF AMERICA, *Respondent.*

**PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT.**

ROBERT ASH,
Munsey Building,
Washington, D. C.
*Attorney for Petitioner.*

*Of Counsel*:
RAY S. FELLOWS,
Kennedy Building,
Tulsa, Oklahoma.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

# INDEX.



## TABLE OF CASES CITED.



## OTHER AUTHORITIES CITED.

IN THE

# Supreme Court of the United States

No.

C. W. Titus, *Petitioner*

v.

The United States of America, *Respondent.*

## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT.

*To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:*

## PETITION.

C. W. Titus prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Tenth Circuit entered in the above-entitled cause June 16, 1945 (R. 86). Petition for rehearing was denied July 24, 1945. The mandate of the Circuit Court is dated August 4, 1945 (R. 96). The Circuit Court affirmed a decision of the United States District Court for the Northern District of Oklahoma holding that the petitioner is not entitled to a refund of income taxes for 1939 and 1940 (R. 23).

## JURISDICTION.

The petition for rehearing was denied by the Circuit Court of Appeals on July 24, 1945. Jurisdiction to issue the writ requested is found in Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

## SUMMARY STATEMENT OF MATTER INVOLVED.

The facts pertinent to this petition, which appear at pages 30-76 of the record, may be summarized as follows:

Prior to December 31, 1927, Titus was the sole stockholder of a corporation, C. W. Titus, Inc., although purely qualifying shares stood in the names of his wife and his sister. On December 31, 1927, the taxpayer, his wife and his sister executed "Articles of Agreement and Declaration of Trust, C. W. Titus Company" (R. 7, 24). The said instrument purported to create a trust for a term of 21 years. The assets of the corporation were transferred to C. W. Titus Company (the "trust") and the corporation was dissolved in 1931. By the terms of the trust instrument, Titus was sole trustee and was to continue as such unless he died, voluntarily resigned, or committed a breach of personal trust. Titus had absolute and complete dominion and control over both the corpus and the income of the trust. He was under no liability to anyone. The only rights of shareholders were (1) a division of declared net profits when and as the same might be distributed by Titus and (2) a division of the property at the termination of the "trust." No shareholder had a right to a partition of the trust property or to an accounting.

Although Titus' wife and sister signed the "Articles of Agreement and Declaration of Trust," they did not contribute anything to the enterprise. Likewise, the wife and sister never had or claimed any equities as beneficiaries. Titus alone was the beneficiary.

The trust instrument provides for certificates of beneficial interest, but no such certificates ever were printed or is-

sued. C. W. Titus Company (the "trust") did not have any officers other than C. W. Titus, the trustee. It did not hold any meetings of holders of beneficial interest, as Titus was the sole beneficiary.

C. W. Titus Company (the "trust") filed returns as a corporation because Titus believed it was an association taxable as a corporation.

All of the facts with respect to the dissolution of the corporation and the creation of the "trust" were reported fully to the Bureau of Internal Revenue and were investigated by revenue agents.

This action was brought for the recovery of 1939 and 1940 income tax in the amounts of $5,689.57 and $2,876.93, respectively. Titus' contention was that C. W. Titus Company (the "trust") was not a legal entity and that the income and deductions of the "trust" and of Titus personally should be consolidated.

The District Court found (R. 26):

> "No doubt, this actually was a business conducted in the name of a trust for the sole benefit of plaintiff * * *."

The Circuit Court of Appeals stated (R. 85):

> "For all practical purposes, Titus was the sole owner of this business."

The Circuit Court decided a taxable association exists. It apparently grounds its decision on estoppel, stating (R. 86), "he (Titus) himself will not now be heard to say that the association is other than what he made it by his solemn instrument of writing."

## QUESTIONS PRESENTED.

### I.

Can there be an association taxable as a corporation when there are no associates and when one person owns and operates the enterprise for his sole benefit?

II.

Does the existence of unused powers make an alleged trust taxable as an association? Or is the test what the trustees actually do, and not the existence of unused powers?

III.

Can there be a trust when there is no present severance of the legal and equitable titles?

IV.

May a Circuit Court of Appeals ignore Sections 166 and 167, Internal Revenue Code, and not tax income to the grantor of a trust when (1) the grantor has power to revest title to any part of the corpus in himself, (2) the grantor may have the income held or accumulated for future disposition to himself, or (3) the grantor may have the income distributed to himself?

V.

May a Circuit Court of Appeals ignore the rule of *Helvering* v. *Clifford*, 309 U. S. 331, and refuse to tax the grantor of a trust when the grantor retains complete dominion and control over the corpus and income of the trust?

VI.

May a Circuit Court of Appeals decide a case on the ground of estoppel when there has been no misrepresentation of fact and there is a mistake of law only?

## REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT.

I.

The Internal Revenue Code does not define "associations" which are taxable as corporations.[1] However, this Court has stated the basic rule that:

> "'Association' implies associates. It implies the entering into a joint enterprise, * * *." *Morrissey* v. *Commissioner*, 296 U. S. 344, 356.

In the case at bar there was no joint enterprise and there were no associates. The Circuit Court states (R. 85):

> "For all practical purposes, Titus was the sole owner of this business."

The District Court found (R. 26):

> "No doubt, this actually was a business conducted in the name of a trust for the sole benefit of plaintiff * * *."

The language of the two lower courts clearly shows that the decision below is in conflict with the *Morrissey* case and the established rule that there must be a joint enterprise and associates in order to make a business an association taxable as a corporation.

II.

In the case at bar the trust instrument provided for the issuance of certificates of beneficial interest and other activities which, if carried out, would have made the enter-

---

[1] The Internal Revenue Code defines corporations as follows:
"Sec. 3797 *Definitions*.
(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * *

(3) *Corporation*. The term 'corporation' includes associations, joint stock companies, and insurance companies."

prise an association. However, the powers never were exercised. The trial court found (R. 26) that "this actually was a business conducted in the name of a trust for the sole benefit of plaintiff."

The court below held that because the trust instrument provided for activities which, if used, would result in an association, an association did, in fact, exist (R. 84-85). This position is in direct conflict with the Sixth Circuit, which states in *Commissioner* v. *Gibbs-Preyer Trusts,* 117 F. (2d) 619, (p. 622):

> "The crucial test in determining whether a trust is an association taxable as a corporation must be found in what *the trustees actually do and not in the existence of long unused powers.* In determining the applicability of the statute *we must look to the actual activities of the entity rather than to its form or possible powers.*" (Italics supplied.)

The Sixth Circuit rule, as quoted above, is consistent with the established law. This Court always has held that regard must be given "to substance and not to form." *Eisner* v. *Macomber,* 252 U. S. 189, 211. The Board of Tax Appeals (now The Tax Court) stated, "What is actually done fixes the tax liability, and not what might have been done * * *." *Minnie C. Brackett, Adm.,* 19 B. T. A. 1154, 1159; affd. without opinion (C. C. A. 7), 57 F. (2d) 1072; Cf. *Willard F. Meyers Machine Co.,* 18 B. T. A. 1069, 1074.

## III.

The *Morrissey* (296 U. S. 344), *Coleman-Gilbert* (296 U. S. 369) and other association cases decided December 16, 1935, have not settled the law with respect to taxation of associations. The *Morrissey* case has been cited approximately 470 times (according to Prentice-Hall Federal Tax Citator). That astounding figure can mean only that the law is in a state of great uncertainty. As the Internal Revenue Code does not define "association," a particular duty rests

on this Court to define the term in such a way as to quiet the flood of litigation involving associations.

## IV.

In the case at bar, Titus owned both the legal and equitable titles to the entire enterprise. Despite that, the Circuit Court held that a separate taxable entity was created. Such a conclusion is contrary to the established rule expressed by the Eighth Circuit in *Morsman* v. *Commissioner*, 90 F. (2d) 18, 27-28, as follows:

> "The trust instrument failed to effect the creation of a trust on January 28, 1928. This results from the fact that *no existing beneficiaries were named* therein and, consequently, *there was no present severance of the legal and equitable titles to the property.* * * * It is true, of course, that in equity a trust may not fail for want of a trustee, nevertheless *the courts cannot supply a private express beneficiary.*" (Italics supplied.)

## V.

In the case at bar Titus has the power (1) to revest title to any part of the corpus in himself, (2) to have the income held or accumulated for future disposition to himself, or (3) to have the income distributed to himself.

Sections 166 and 167, Internal Revenue Code, specifically provide[1] that in the circumstances mentioned the income of a trust is taxable to the grantor. The court below completely ignored those sections of the statute.

## VI.

In *Helvering* v. *Clifford*, 309 U. S. 331, this Court stated that the income of a trust is taxable to the grantor when the grantor retains substantial dominion and control over the corpus of the trust. In the case at bar the Circuit Court stated (R. 84):

---

[1] Sections 166 and 167 are set out in full at page 10 of the Appendix of this petition.

"For all practical purposes, Titus was the sole owner of this business."

The District Court, in disposing of this case, stated (R. 26) that "this actually was a business conducted in the name of a trust for the sole benefit of plaintiff."

The rule of the *Clifford* case seems clearly applicable to a trust such as this, where the donor has complete dominion and control over both the corpus and the income of the trust.

## VII.

The Circuit Court decided this case on the ground of estoppel, even though all of the pertinent facts were reported on the returns and were investigated by revenue agents. The decision below is in direct conflict with the established law that there can be no estoppel when there is a mistake of law only and the Commissioner was not misinformed as to the facts. The Eighth Circuit has expressed the rule as follows:

> "If the mistake is one of law only, and the Commissioner fails to establish that he was misinformed as to the facts, there can be no estoppel. (Citing cases.) Further, if the taxpayer makes timely disclosure of all the material facts to the Commissioner or to his representative there can be no ground for estoppel." *Helvering* v. *Williams*, 97 F. (2d) 810, 812.

Other cases expressing the same rule and which, therefore, are in conflict with the case at bar, are *American Light & Traction Co.* v. *Harrison* (C. C. A. 7). 142 F. (2d) 639; *United States* v. *Dickinson* (C. C. A. 1), 95 F. (2d) 65; *Helvering* v. *Brooklyn City R. R. Co.* (C. C. A. 2), 72 F. (2d) 274.

## CONCLUSION.

From the foregoing it is clear that the petition, under Rule 38(5)(b), should be granted because:

1. The decision of the Tenth Circuit is in conflict with the established law that "'association' implies associates. It implies the entering into a joint enterprise." *Morrissey* v. *Commissioner,* 296 U. S. 344, 356.

2. The Internal Revenue Code does not define "associations" taxable as corporations, consequently, a particular duty rests on this Court to define the term in such a way as to quiet the flood of litigation involving "associations."

3. The decision of the Tenth Circuit is in conflict with the Sixth and Seventh Circuits in *Commissioner* v. *Gibbs-Preyer Trusts,* 117 F. (2d) 619, and *American Light & Traction Co.* v. *Harrison,* 142 F. (2d) 630.

4. The decision of the Tenth Circuit so far departs from the accepted and usual course of judicial proceedings as to call for the exercise of this Court's power of supervision.

Robert Ash,
Munsey Building,
Washington, D. C.
*Attorney for Petitioner.*

*Of Counsel*:
Ray S. Fellows,
Kennedy Building,
Tulsa, Oklahoma.

October, 1945.

## APPENDIX.

### Sections 166 and 167, Internal Revenue Code.

SECTION 166. REVOCABLE TRUSTS.

Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust shall be included in computing the net income of the grantor.

SECTION 167. INCOME FOR BENEFIT OF GRANTOR.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23 (o), relating to the so-called "charitable contribution" deduction);

then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section, the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question."

# INDEX



## CITATIONS





672680—45

# In the Supreme Court of the United States

OCTOBER TERM, 1945

---

No. 535

C. W. TITUS, PETITIONER

*v.*

UNITED STATES OF AMERICA

---

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT*

---

**BRIEF FOR THE UNITED STATES IN OPPOSITION**

---

**OPINION BELOW**

The district court did not write an opinion. The opinion of the Circuit Court of Appeals (R. 81–86) is reported in 150 F. 2d 508.

**JURISDICTION**

The judgment of the Circuit Court of Appeals was entered on June 26, 1945 (R. 86–87) and rehearing was denied by that court on July 24, 1945 (R. 96). The petition for a writ of certiorari was filed on October 19, 1945. The jurisdiction of this Court is invoked under Section

240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

## QUESTION PRESENTED

Whether the C. W. Titus Company was an association taxable as a corporation in the taxable years in question within the meaning of Section 3797 of the Internal Revenue Code.

## STATUTE INVOLVED

Internal Revenue Code:

> SEC. 3797. DEFINITIONS.
>
> (a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—
>
> * * * * *
>
> (3) *Corporation.*—The term "corporation" includes associations, joint-stock companies, and insurance companies.
>
> * * * * *
>
> [26 U. S. C. 3797.]

## STATEMENT

The facts found by the district court (R. 23-26) and restated by the Circuit Court of Appeals in its opinion (R. 81-82) may be summarized as follows:

C. W. Titus, Inc., was incorporated under the laws of Oklahoma in 1926. Of its 3,000 shares of capital stock, 2,998 shares were issued to the taxpayer and one share each to his wife and sister. In the same year, the corporation sold

its oil and gas producing properties and immediately invested $1,576,098.16 of the proceeds thereof in stocks and bonds. It continued to carry on its business until December 31, 1927, at which time its three stockholders entered into an agreement designated "Articles of Agreement and Declaration of Trust," by which a trust was set up under the name of the C. W. Titus Company. The corporation transferred all of its assets to the Company in exchange for the 3,000 shares of stock it had issued and, in 1931, was dissolved. (R. 24.) Under the "Articles of Agreement and Declaration of Trust" (R. 7-18) the taxpayer and his wife and sister became the subscribers to the 300,000 shares of beneficial interest which the trust was authorized to issue and the taxpayer was designated as the first trustee. The trustee had very broad powers and was authorized to acquire all kinds of property and manage or sell it, and particularly to deal in stocks and securities and in oil properties. The trust was to run for a period of twenty-one years, unless previously dissolved. No provisions was made empowering the shareholders to discharge the trustee or to exercise any control over his acts. All assets of the Company came from the corporation, except the financial gain from the use of property or funds which it had acquired from the corporation. (R. 24-25.)

No taxable gain was reported by the C. W. Titus Company or by the taxpayer at the time

the C. W. Titus Company acquired the corporation's assets. On the contrary, the Company and the corporation filed consolidated or joint corporate income tax returns from the time of the creation of the Company until the corporation was dissolved in 1931. After that and through the year 1940, the company filed a corporate income tax return, as is required of "associations," by which it was designated "Oil and Investment Trust, Acts as principal." The taxpayer filed separate individual returns during all this time. During the greater portion of its existence, the C. W. Titus Company did many things indicating a claim of corporate character. (R. 25–26.) Both the taxpayer and the Government throughout all the years regarded the C. W. Titus Company as an "association" within the meaning of the federal income tax laws and considered that the company was correct in not reporting a taxable gain at the time it received the assets of the corporation, because the transfer was a tax-free reorganization of C. W. Titus, Inc. (R. 26).

The taxpayer did not assert his present position (that the transfer of the corporate assets in 1928 to the C. W. Titus Company was in effect a transfer to him personally and that all of the transactions of the Company were his own personal transactions) until the time had passed when the Government could legally demand the additional tax for the taxable gain of the tax-

payer in acquiring the assets of the corporation (R. 26). The district court concluded that the taxpayer should be denied recovery and that judgment should be entered for the United States (R. 27). The Circuit Court of Appeals affirmed the district court's judgment (R. 86–87).

## ARGUMENT

1. The alleged conflict between the decision of the court below and that of this Court in *Morrissey* v. *Commissioner,* 296 U. S. 344, on the question of whether the C. W. Titus Company was an association within the meaning of the applicable statute is non-existent. The court below applied the principles of the *Morrissey* case, *supra,* to the peculiar facts upon which this case rests and concluded, correctly we think, that the company was not a pure trust but a business association.

There was here an association of three persons who in 1927 organized the company as a business trust, with the avowed purpose of permitting others to join it as associates. There was a trust corpus and a business purpose, and the management of the Company's business activities was placed in the hands of a trustee. The life of the enterprise was fixed at twenty-one years, and it was expressly provided that the shareholders could not require that the trust be dissolved. The Company's shares were saleable

and transferable on the books of the association, and the liability of the trustee, as well as of the shareholders, was limited, except that, as is usual in similar situations, the trustee was held liable for breach of personal trust.

From its organization in 1927 to and including the taxable years here in question, 1939 and 1940, the Company was treated by all concerned as an association, particularly for tax purposes, but for other purposes as well (R. 26). Thus it was regarded as having been formed in the course of a non-taxable corporate reorganization, with the result that no tax was paid in respect of the distribution to it in 1928 of the assets of its predecessor corporation. Since the bar of the statute of limitations has fallen with respect to the year 1928 (R. 24, 26), moreover, no tax can be imposed with respect to the receipt of income at that time. And unless the Company is an association, as the court below held it to be, the eventual distribution to the petitioner of the property originally held by the corporation will give rise to no tax liability even if that distribution results in gain to the petitioner. It is the apparent purpose of this suit to obtain a judgment founded on the assumption that the property of the Company is already, in substance, that of the petitioner, and upon the basis of which the petitioner's eventual receipt of the assets will be deemed tax free.

The petitioner asserts that the decision below conflicts with that of the Sixth Circuit Court of

Appeals in *Commissioner* v. *Gibbs-Preyer Trusts Nos. 1 & 2*, 117 F. 2d 619, with respect to the statement made by the latter court to the effect that the test, in determining whether a trust is an association, must be found in what the trustees actually do rather than in the existence of unused powers. This statement, however, must be viewed in the light of the peculiar facts in that case and the actual basis of the court's decision which was that the terms of the written instrument, as to the trustee's powers there involved, were not intended to and did not become operative so long as the properties were managed by members of the family or beneficiaries in view of a contemporaneous oral agreement between the parties to that effect. There is therefore no conflict between the *Gibbs-Preyer* decision and the decision below. It is well settled that the parties to a trust instrument are not at liberty to say that their purpose was other or narrower than that which they formally set forth in the instrument. *Helvering* v. *Coleman-Gilbert,* 296 U. S. 369, 374. The fact that the Company's business may actually have been conducted for the sole benefit of the petitioner is, therefore, irrelevant.

2. Likewise without merit is the petitioner's contention that the income of the trust should be held taxable to him under Sections 166 or 167, or, in the alternative, under Section 22 (a) of the Internal Revenue Code in accordance with

the principle of *Helvering* v. *Clifford,* 309 U. S. 331. No more need be said with regard thereto than that the contention assumes that the C. W. Titus Company was not an association but a pure trust, contrary to the finding of both the district court and the court below.

## CONCLUSION

The decision of the court below is correct and there is no conflict. The petition for a writ of certiorari should be denied.

Respectfully submitted.

J. Howard McGrath,
*Solicitor General.*

Samuel O. Clark, Jr.,
*Assistant Attorney General.*

Sewall Key,
Robert N. Anderson,
Carlton Fox,
*Special Assistants to the Attorney General.*

November 1945.

U. S. GOVERNMENT PRINTING OFFICE: 1945

## CITATIONS.

IN THE

# Supreme Court of the United States

No. 535.

C. W. TITUS, *Petitioner*,

v.

THE UNITED STATES OF AMERICA, *Respondent*.

## REPLY TO GOVERNMENT'S BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI.

I.

The Government's first ground of opposition (Br. 6) is:

> "Since the bar of the statute of limitations has fallen with respect to the year 1928 (R. 24, 26), moreover, no tax can be imposed with respect to the receipt of income at that time."

Consequently, it argues that certiorari should be denied. The position of the Government on this point is directly contrary to (1) the statute and (2) the law established by this Court.

In order to secure certainty in connection with taxation, Congress, in the 1928 Act, enacted Sections 607 and 609, which are now Sections 3770 and 3775, Internal Revenue Code.

The Sections mentioned provide that if a tax is collected or credited after the expiration of the statute of limitations, such assessment or credit is an overpayment which must be refunded.[1]

This Court passed squarely on Section 607 of the 1928 Act in *McEachern* v. *Rose,* 302 U. S. 56, 19 A. F. T. R. 1207. In the *McEachern* case, returns were filed which were "erroneous in point of fact and of law." The Government contended that, in view of the erroneous statements of fact in the returns, the taxpayer was estopped to deny the correctness of such statements. This Court held that equitable principles would ordinarily prevail. However, because Congress had enacted Section 607, the statute must prevail over equity. In the *McEachern* case, the Court clearly distinguishes *Stone* v. *White,* 301 U. S. 532, 19 A. F. T. R. 503. The *Stone* case involved a situation where the beneficiary of a trust wholly failed to report certain income received by her.[2]

In the Revenue Act of 1938, Congress took cognizance of the *McEachern* decision in Section 820, "Mitigation of Effect of Limitations and Other Provisions in Income Tax Cases," which is retained in the Internal Revenue Code as Section 3801.[3] The purpose of the Section is to prevent taxpayers or the Government from taking inconsistent positions in later years as compared with that taken in prior outlawed years. In such circumstances adjustment can be made for the prior years, irrespective of the statute of limi-

---

[1] The Sections and the Finance Committee Report explaining them are set out in the appendix to this reply, at page 5.

[2] The *McEachern* decision is in line with the better thought on the subject of applying equitable principles to tax cases. See the excerpt from the Report of the Standing Committee on Federal Taxation, American Bar Association, September, 1937, which is set out in the appendix to this reply, at page 6.

[3] The Section and the Finance Committee Report explaining this section are set out in full in the appendix to this reply, at pages 7 and 11, respectively.

tations. However, the Conference Committee added subsection (f), which states:

> "No adjustment shall be made under this section in respect of any taxable year beginning prior to January 1, 1932."

The most that can be said of the case at bar is that the taxpayer has taken an inconsistent position. The first position was taken prior to January 1, 1932. In view of the specific statutory direction that no adjustment be made in respect of any year beginning prior to January 1, 1932, the position of the Government is clearly in error. This is true because "The entire Federal tax structure is a creature of Congress." *New Hampshire Fire Insurance Co.*, 2 T. C. 708, 722, affirmed (C. C. A. 1) 146 F. (2d) 697.

## II.

At page 5, the Government's reply states, "There was here an association of three persons * * *."

The Government then asks this Court to dispose of this case because three persons signed a trust instrument. This unrealistic taxation is sought despite the findings of the courts below, as follows:

The District Court found (R. 26):

> "No doubt, this actually was a business conducted in the name of a trust for the sole benefit of plaintiff * * *."

The Circuit Court of Appeals stated (R. 85):

> "For all practical purposes, Titus was the sole owner of this business."

The real question here involved is whether this Court is going to permit the taxation as an association of a business which both lower courts distinctly state was the sole business of Titus. In view of the findings of the lower courts, it is obvious that the decision in this case is in conflict with *Morrissey* v. *Commissioner,* 296 U. S. 344.

III.

The Government admits (Br. 7) that *Commissioner* v. *Gibbs-Preyer Trusts*, 117 F. (2d) 619, holds "to the effect that the test, in determining whether a trust is an association, must be found in what the trustees actually do rather than in the existence of unused powers."

The decision in the *Gibbs-Preyer* case unequivocally states the rule to be as indicated. An effort to evade unequivocal language of respected courts can mean only confusion, uncertainty, and ever-increasing litigation.

## CONCLUSION.

The writ of certiorari should issue.

Robert Ash,
Munsey Building,
Washington, D. C.,
*Attorney for Petitioner.*

*Of Counsel:*
Ray S. Fellows,
Kennedy Building,
Tulsa, Oklahoma.

November, 1945.

# APPENDIX.

## Sections 607 and 609, 1928 Revenue Act (Now Sections 3770 and 3775, Internal Revenue Code).

"Sec. 607. *Effect of Expiration of Period of Limitation against United States.*

"Any tax (or any interest, penalty, additional amount, or addition to such tax) assessed or paid (whether before or after the enactment of this Act) after the expiration of the period of limitation properly applicable thereto shall be considered an overpayment and shall be credited or refunded to the taxpayer if claim therefor is filed within the period of limitation for filing such claim."

"Sec. 609. *Erroneous Credits.*

"(a) Credit against barred deficiency.—Any credit against a liability in respect of any taxable year shall be void if any payment in respect of such liability would be considered an overpayment under section 607."

## Finance Committee Report (Report 960, 70th Congress, 1st Session) Dealing with Sections 607 and 609, 1928 Revenue Act.

"Sec. 607. *Effect of Expiration of Period of Limitation against United States.*

"Section 1106(a) of the 1926 act failed to resolve many doubtful questions as to the legal effect which follows the expiration of the period of limitation prescribed for the assessment or collection of a tax or for the making of a refund or credit or the bringing of a suit for refund. Section 1106(a) of the 1926 act is repealed as of its effective date and is replaced by sections 607, 608, 609, and 610 of this bill.

Section 607 of the bill prescribes the effect to be given to the expiration of a period of limitation against the United States and section 608 relates to the effect of the expiration of a period of limitation against the taxpayer.

"Section 607 provides that regardless of the correct tax liability any payment shall be an overpayment if made pursuant to an assessment after the expiration of the period of limitation on assessment (no assessment hav-

ing been made within such period) or after the expiration of the period of limitation on collection by distraint or court proceedings (no distraint or court proceeding having been begun within such period). It is immaterial whether the payment was voluntary or involuntary, and duress is also of no significance in determining the right to recover an amount paid after the statute has run. An overpayment under section 607 is to be credited or refunded the same as any other overpayment.

"Section 607 is applicable to payments made before or after the enactment of this act. Any such overpayment shall be credited or refunded, however, only if claim therefor is filed within the proper period of limitation.

"Sec. 609. *Erroneous Credits.*

"Section 609 provides that a credit of an overpayment against a barred deficiency or a credit of a barred overpayment against a deficiency which is not barred shall be void if payment of the deficiency in the first case or the making of a refund in the second would constitute an overpayment or an erroneous refund under section 607 or 608.

"Section 609 applies to any credit made before or after the enactment of this act."

**Report of the Standing Committee on Federal Taxation, American Bar Association Meeting, September, 1937.**

While there are impressive arguments in favor of courts' seeking to 'do justice' in particular cases, so far as is possible without violating the letter of the statute, it is beginning to be clear that if courts go too far into the legislative field in adjudicating tax cases, the public interest will be injured by gradually driving more and more tax cases into the courts. The more lawsuits a taxation system produces, the worse for the Government and its revenues; administrative processes are in general better adapted to revenue collection. Uncertainty as to the final outcome produces lawsuits, and uncertainty is produced whenever the outcome of a case is made to depend on the rough justice of that particular case. Taxation legislation is peculiar, in that it contemplates as a normal thing a vast number of transactions between the Government and its citizens, and those transactions cannot proceed in an orderly administra-

tive way unless the final result is reasonably predictable.

In older court opinions over a long period, statements are frequently found that if a statute is inequitable either to the taxpayer or to the Government, the remedy lies with Congress. This position was in part predicated on the consideration that for many years it has been the practice of Congress to give frequent attention to revenue laws, amending them when they needed it—the theory being that when a doctor is present, there is little reason for a layman to prescribe. In later years, however, the courts have occasionally shown a somewhat different tendency—to go beyond the mere 'interstices' and to soften or stiffen the law by interpretation according to their views of the case before them. This tendency has, perhaps, been more observable when the so-called 'equities' were urged in favor of the Government. Even when the Government succeeds in urging such an equitable construction, the ultimate result may be against the Government's interest, because in subsequent cases, where the positions of the Government and the contending taxpayers are reversed, the result is to confuse a statute which need not have been confused.

Tendencies to apply a rather one-sided equitable construction are, perhaps, being checked even now, as may be indicated by the more careful position taken by the courts in very recent decisions in cases where the Government sought to estop a taxpayer from relying on the true facts.

It is the view of the Committee that the substantial number of tax cases pending in courts at this time is in part due to the unpredictability as to the result in many problems affecting the revenue and that this situation is fostered in part by 'rough justice' in court decisions.

**Section 820, 1938 Revenue Act (Now, as Amended, Section 3801, Internal Revenue Code).**

SEC. 820. MITIGATION OF EFFECT OF LIMITATION AND OTHER PROVISIONS IN INCOME TAX CASES.

(a) *Definitions.*—For the purpose of this section—

(1) *Determination.*—The term "determination under the income tax laws" means—

(A) A closing agreement made under section 606 of the Revenue Act of 1928, as amended;

(B) A decision by the Board of Tax Appeals or a judgment, decree, or other order by any court of competent jurisdiction, which has become final; or

(C) A final disposition by the Commissioner of a claim for refund. For the purposes of this section a claim for refund shall be deemed finally disposed of by the Commissioner—

(i) as to items with respect to which the claim was allowed, upon the date of allowance of refund or credit or upon the date of mailing notice of disallowance (by reason of offsetting items) of the claim for refund, and

(ii) as to items with respect to which the claim was disallowed, in whole or in part, or as to items applied by the Commissioner in reduction of the refund or credit, upon expiration of the time for instituting suit with respect thereto (unless suit is instituted prior to the expiration of such time).

Such term shall not include any such agreement made, or decision, judgment, decree, or order which has become final, or claim for refund finally disposed of, prior to ninety days after the date of the enactment of this Act.

(2) *Taxpayer.*—Notwithstanding the provisions of section 901, the term "taxpayer" means any person subject to a tax under the applicable Revenue Act.

(3) *Related taxpayer.*—The term "related taxpayer" means a taxpayer who, with the taxpayer with respect to whom a determination specified in subsection (b) (1), (2), (3), or (4) is made, stood, in the taxable year with respect to which the erroneous inclusion, exclusion, omission, allowance, or disallowance therein referred to was made, in one of the following relationships: (A) husband and wife; (B) grantor and fiduciary; (C) grantor and beneficiary; (D) fiduciary and beneficiary, legatee, or heir; (E) decedent and decedent's estate; or (F) partner.

(b) *Circumstances of Adjustment.*—When a determination under the income tax laws—

(1) Requires the inclusion in gross income of an item which was erroneously included in the gross income of the taxpayer for another taxable year or in the gross income of a related taxpayer; or

(2) Allows a deduction or credit which was erroneously allowed to the taxpayer for another taxable year or to a related taxpayer; or

(3) Requires the exclusion from gross income of an item with respect to which tax was paid and which was erroneously excluded or omitted from the gross income of the taxpayer for another taxable year or from the gross income of a related taxpayer; or

(4) Allows or disallows any of the additional deductions allowable in computing the net income of estates or trusts, or requires or denies any of the inclusions in the computation of net income of beneficiaries, heirs, or legatees, specified in section 162 (b) and (c) of this Act, and corresponding sections of prior revenue Acts, and the correlative inclusion or deduction, as the case may be, has been erroneously excluded, omitted, or included, or disallowed, omitted, or allowed, as the case may be, in respect of the related taxpayer; or

(5) Determines the basis of property for depletion, exhaustion, wear and tear, or obsolescence, or for gain or loss on a sale or exchange, and in respect of any transaction upon which such basis depends there was an erroneous inclusion in or omission from the gross income of, or an erroneous recognition or nonrecognition of gain or loss to, the taxpayer or any person who acquired title to such property in such transaction and from whom mediately or immediately the taxpayer derived title subsequent to such transaction—

and, on the date the determination becomes final, correction of the effect of the error is prevented by the operation (whether before, on, or after the date of enactment of this Act) or any provision of the internal-revenue laws other than this section and other than section 3229 of the Revised Statutes, as amended (relating to compromises), then the effect of the error shall be corrected by an adjustment made under this section. Such adjustment shall be made only if there is adopted in the determination a position maintained by the Commissioner (in case the amount of the adjustment would be refunded or credited in the same manner as an overpayment under subsection (c)) or by the taxpayer with respect to whom the determination is made (in case the amount of the adjustment would be assessed and collected

in the same manner as a deficiency under subsection (c)), which position is inconsistent with the erroneous inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be. In case the amount of the adjustment would be assessed and collected in the same manner as a deficiency, the adjustment shall not be made with respect to a related taxpayer unless he stands in such relationship to the taxpayer at the time the latter first maintains the inconsistent position in a return, claim for refund, or petition (or amended petition) to the Board of Tax Appeals for the taxable year with respect to which the determination is made, or if such position is not so maintained, then at the time of the determination.

(c) *Method of Adjustment.*—The adjustment authorized in subsection (b) shall be made by assessing and collecting, or refunding or crediting, the amount thereof, to be ascertained as provided in subsection (d), in the same manner as if it were a deficiency determined by the Commissioner with respect to the taxpayer as to whom the error was made or an overpayment claimed by such taxpayer, as the case may be, for the taxable year with respect to which the error was made, and as if on the date of the determination specified in subsection (b) one year remained before the expiration of the periods of limitation upon assessment or filing claim for refund for such taxable year.

(d) *Ascertainment of Amount of Adjustment.*—In computing the amount of an adjustment under this section there shall first be ascertained the tax previously determined for the taxable year with respect to which the error was made. The amount of the tax previously determined shall be (1) the tax shown by the taxpayer, with respect to whom the error was made, upon his return for such taxable year, increased by the amounts previously assessed (or collected without assessment) as deficiencies, and decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax; or (2) if no amount was shown as the tax by such taxpayer upon his return, or if no return was made by such taxpayer, then the amounts previously assessed (or collected without assessment) as deficiencies, but such amounts previously assessed, or collected without assessment, shall be decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax. There shall then be ascertained the increase or

decrease in the tax previously determined which results solely from the correct exclusion, inclusion, allowance, disallowance, recognition, or nonrecognition, of the item, inclusion, deduction, credit, gain, or loss, which was the subject of the error. The amount so ascertained (together with any amounts wrongfully collected, as additions to the tax or interest, as a result of such error) shall be the amount of the adjustment under this section.

(e) *Adjustment Unaffected by Other Items, etc.*—The amount to be assessed and collected in the same manner as a deficiency, or to be refunded or credited in the same manner as an overpayment, under this section, shall not be diminished by any credit or set-off based upon any item, inclusion, deduction, credit, exemption, gain, or loss other than the one which was the subject of the error. Such amount, if paid, shall not be recovered by a claim or suit for refund or suit for erroneous refund based upon any item, inclusion, deduction, credit, exemption, gain, or loss other than the one which was the subject of the error.

(f) *No adjustment for Years Prior to 1932.*—No adjustment shall be made under this section in respect of any taxable year beginning prior to January 1, 1932.

**Finance Committee Report (Report 1567, 75th Congress, 3rd Session) Dealing with Section 820, 1938 Revenue Act.**

SECTION 819. MITIGATION OF THE EFFECT OF LIMITATION AND OTHER PROVISIONS IN INCOME TAX CASES.

This section of the bill provides an equitable solution of certain classes of income-tax problems, now very numerous, which have caused much hardship to taxpayers and great difficulty to the Commissioner, the Board of Tax Appeals, and the courts. The general nature of these problems is best disclosed by examples:

A. Taxpayer A, who reports income on the cash basis, erroneously included in his return for 1933 an item of accrued rent, and upon audit the return was accepted as filed. In 1938, after the period of limitations on refund claims for 1933 had expired, the Commissioner discovered that A received this rent in 1934, and consequently asserted and, after decision of the Board of Tax Appeals upholding

such assertion, collected a deficiency assessment for the latter year. To prevent A from being subjected to an unfair double tax burden on account of a single item of income, an adjustment would be made under the proposed legislation.

B. A father and son conducted a partnership business in which each had an equal interest. The father included the entire partnership income in his return for 1933 and the son included no portion of this income in his return for that year. One week before the statute of limitations had run with respect to deficiencies and refund claims for both father and son for 1933, the father filed a refund claim for that portion of his 1933 tax attributable to the half of the partnership income which should have been included in the son's return. The court sustained the claim for refund. To prevent the two partners from entirely avoiding payment of tax with respect to one-half of the partnership income through such inconsistent action by the father, an adjustment would be made under the proposed legislation.

C. In 1931 the taxpayer received securities of corporation A having a fair market value of $5,000 in exchange for securities of corporation B which cost him $12,000. The taxpayer treated the exchange as one in which gain or loss was not recognizable and upon audit the return was accepted as filed. He sold the A securities in 1937 for $15,000 and reported $3,000 gain. After the statute of limitations had run on refund claims for 1931, the Commissioner asserted a deficiency for 1937 on the ground that the loss realized on the exchange in 1931 was erroneously treated as nonrecognizable, and that the basis for gain or loss upon the sale was $5,000, resulting in a gain of $10,000. The taxpayer and the Commissioner then entered into a closing agreement for 1937 in which the taxpayer agreed to the Commissioner's determination. To prevent the inconsistent resort to the lower basis resulting in complete denial of a deduction for the loss sustained in 1931, an adjustment would be made under the proposed section.

In each case, under existing law, an unfair benefit would have been obtained by assuming an inconsistent position and then taking shelter behind the protective barrier of the statute of limitations. Such resort to the statute of limitations in a plain misuse of its fundamental purpose. The purpose of the statute of limitations to prevent the litiga-

tion of stale claims is fully recognized and approved. But it was never intended to sanction active exploitation, by the beneficiary of the statutory bar, of opportunities only open to him, if he assumes a position diametrically opposed to that taken prior to the running of the statute. The Federal courts in many somewhat similar tax cases have sought to prevent inequitable results by applying principles variously designated as estoppel, quasi-estoppel, recoupment and set-off. For various reasons, mostly technical, these judicial efforts cannot extend to all problems of this type. Nor can they provide a uniform, systematic solution of these problems. Legislation has long been needed to supplement the equitable principles applied by the courts and to check the growing volume of litigation by taking the profit out of inconsistency, whether exhibited by taxpayers or revenue officials and whether fortuitous or the result of design.

The legislation here proposed is based upon the following principles:

(1) To preserve unimpaired the essential function of the statute of limitations, corrective adjustments should (a) never modify the application of the statute except when the party or parties in whose favor it applies shall have justified such modification by active inconsistency, and (b) under no circumstances affect the tax saved with respect to the influence of the particular items involved in the adjustment.

(2) Subject to the foregoing principles, disputes as to the year in which income or deductions belong, or as to the person who should have the tax burden of income or the tax benefit of deductions, should never result in a double tax or a double reduction of tax, or an inequitable avoidance of tax.

(3) Disputes as to the basis of property should not allow the taxpayer or the Commissioner to obtain an unfair tax advantage by taking one position at the time of the acquisition of property and an inconsistent position at the time of its disposition.

(4) Corrective adjustments should produce the effect of attributing income or deductions to the right year and the right taxpayer, and of establishing the proper basis.

Other provisions of the internal revenue laws, as well as the statute of limitations, make profitable the taking of inconsistent positions by providing a safe shelter for the

party changing his position. Thus, in example A, suppose the statute of limitations had not yet run on refund claims for 1933 when the Commissioner asserted a deficiency for 1934, but the taxpayer and the Commissioner had entered into a closing agreement for the year 1933 so that the taxpayer would be prevented from reopening that year. The result of a double tax would likewise follow from the collection of the deficiency. While cases involving these other provisions are less frequent, the results produced are just as inequitable, and as they admit of the same adjustment as cases involving the statute of limitations, they are also covered by the proposed legislation.

Subsection (b) provides that the effect of the error shall be corrected in the manner provided in this section only if, at the time the determination becomes final, correction would be prevented by some provision of the internal revenue laws. Thus, in example A above, if the period for filing claims for refund had not expired at the time the decision of the Board sustaining the deficiency for 1934 became final so that the taxpayer could proceed to file a refund claim for 1933, this section would not be operative. In other words, this section does not prescribe an exclusive procedure for correcting the errors dealt with, but merely authorizes this particular procedure if correction is otherwise prevented. It should be observed that the section applies either where correction is barred by the running of the statute of limitations, by the execution of a closing agreement, by the collateral consequences of a Board proceeding, etc., prior to the date of enactment of this act, or by similar events happening after the effective date of this act.

Inasmuch as an adjustment should not be made until the inconsistent position asserted by the taxpayer or the Commissioner has been successfully maintained, subsection (b) is not operative until there is a final "determination" which gives authoritative sanction to the inconsistent action. Subsection (a) describes the types of determinations which are prerequisite to the operation of this section.

Subsection (b), with the interpretations afforded by the definitions in subsection (a), describes the circumstances under which an adjustment is authorized by this section. As the above examples indicate, the section is not restricted to single taxpayers but covers two or more taxpayers in appropriate cases. Paragraphs (1)-(4) of subsection (b)

group these taxpayers under the term "related taxpayer" and this term is defined in paragraph (2) of subsection (a). The definition covers those situations in which, for reasons apparent from the nature of the relationship, the problems dealt with by this section are likely to arise. Paragraph (5) of subsection (b) covers both the person who acquired the property and any subsequent transferees and donees who have a substituted basis ascertained by reference to the basis in the hands of such person.

It should be noted that only such transfers as occur subsequent to the transaction erroneously treated are covered by this paragraph, so as to avoid the confusion, hardship, and wasted effort which would result if reorganizations and other transactions were entirely readjusted when any one participant took inconsistent stands. For example, if partnership assets are transferred to a corporation in exchange for its stock and one of the partners on later disposition of the stock adopts a position with respect to the basis of the stock inconsistent with that taken at the time of the transfer, an adjustment would be made under this section only with respect to such partner. If the other partner, however, later shifted his position, an adjustment with respect to him would then be authorized under this section. An adjustment with respect to the corporation is not authorized by reason of the inconsistent position taken by either or both of the partners as the corporation derived title at the time of the erroneously treated transaction and not subsequent thereto. But if the corporation later shifted its position, an adjustment with respect to the corporation would then be authorized.

The adjustment is described in subsections (c), (d), and (e). Subsection (c) describes the first stage in the process, that of ascertaining the amount of the adjustment. In ascertaining the amount of the adjustment, two steps are involved;

(a) The tax previously determined for the taxable year with respect to which the error was made must first be ascertained. In ordinary cases this will simply be the amount of tax shown on the taxpayer's return. If any changes in that amount have been made, however, they must be taken into account. In such cases, the tax previously determined will be the tax as shown on the return, increased by any amounts previously assessed as deficiencies and decreased by any amounts previously repaid in respect of such tax.

(b) With the tax previously determined as the datum point, a recomputation must then be made to ascertain the increase or decrease, if any, resulting from correction of the error. In the ordinary case this will merely require a recomputation of the tax shown on the return, as affected by correct treatment of the item involved in the determination. If the amount of tax shown on the return had previously been increased or decreased by reason of deficiencies assessed or amounts repaid, the return would in effect be reconstructed to reflect these changes and the recomputation to ascertain the increase or decrease made on the basis of such reconstructed return. Such increase or decrease, together with any amounts wrongfully collected from the taxpayer, as additions to the tax or interest, as a result of the error, constitutes the amount of the adjustment.

The recomputation does not involve consideration of the treatment of any other items for the taxable year with respect to which the recomputation is made, except, of course, those items considered in ascertaining the tax previously determined to serve as the basis of the recomputation. Thus, in example A, if the taxpayer had failed to take a deduction properly allowable for a loss sustained in 1933, and the statute had run on claims for refund, the recomputation to ascertain the change necessitated by correction of the erroneous inclusion in gross income of the rent item would not permit correct treatment of the loss. Similarly, if the taxpayer had failed to include in his gross income commissions received in that year, and the statute had run on deficiency assessments, the recomputation would not permit inclusion of such commissions.

As indicated above, this section is predicated on the principle that correction is made only with respect to the item involved in the determination. The operation of the bar of statute of limitations is not affected with respect to any other item, even though such other item also had been erroneously treated in the same year. As to these items there has been no change of position, no double tax or double deduction, to call for the relief provided by this section. Accordingly, if the amount of the adjustment in example A ascertained by a recomputation of the tax after exclusion of the rent item from gross income were a decrease of $500 in tax, and the inclusion of the commissions erroneously omitted from the return would have not only eliminated such decrease but would have resulted in a $100

increase in tax, the amount of the adjustment nevertheless remains $500 decrease in tax and, under subsection (d), is to be refunded to the taxpayer.

Subsection (d) prescribes the method of adjustment. If the amount of the adjustment ascertained pursuant to subsection (c) represents an increase in tax, it is to be considered as a deficiency for the taxable year with respect to which the error was made; if it represents a decrease in tax, it is to be considered as an overpayment for that year. The amount of the adjustment considered as a deficiency or as an overpayment, as the case may be, will bear interest to the extent provided by the internal revenue laws for deficiencies and overpayments for the taxable year with respect to which the error was made. Likewise, if the amount of the adjustment represents an increase in tax, any appropriate additions to the tax are also to be assessed and collected. By considering the amount of the adjustment as a deficiency or as an overpayment, subsection (d) permits the utilization of the procedural devices applicable to assessment, collection, refunding, etc., of deficiencies and overpayments.

Subsection (e) supplements the limitations provided in subsection (c) to the effect that the adjustment is unaffected by any other items not taken into consideration in ascertaining the tax previously determined.